



Working together since 1967 to preserve federalism and tax fairness

To: Executive Committee
From: Joe Huddleston
Date: July 28, 2008
Subject: 2007-2008 Annual Report of the Executive Director

This report is a summary of the Commission's organizational and staff activities for the period July 1, 2007, through June 30, 2008.

I. Programs & Activities

A. Joint Audit Program

Audit Program completed 7 income tax audits and parts of 2 other income tax audits. The Audit Program also completed 9 sales tax audits and parts of 2 other sales tax audits. There are 18 income and 32 sales tax audits in progress.

Because Georgia and Illinois joined the MTC Joint Audit Program, the Audit Program was authorized to add an additional income and an additional sales tax auditor. A sales tax auditor was hired in April; the Commission is still recruiting for an additional income tax auditor.

Several staff members of the Joint Audit Program along with the Commission's deputy director continue to work on revising the Joint Audit Program Income and Sales Tax Audit manuals and processes. A draft revision the Income Tax Manual is nearly completed; a draft revision of the Sales Tax Manual will take longer. An in-progress draft of both manuals was distributed to the Audit Committee at its meeting on March 13, 2008.

The entire Joint Audit Program staff met in Chicago the week of November 12, 2007, for training. Illinois and Wisconsin provided much of the training, which we greatly appreciate.

The Joint Audit Program staff continues to work with the Audit Committee and periodic working groups. A working group comprised of four state representatives and the Audit Program Director developed a recommendation to improve the audit selection process that was approved by the Audit Committee. Three members of the Audit Committee and the Joint Audit Program director are participating in a working group

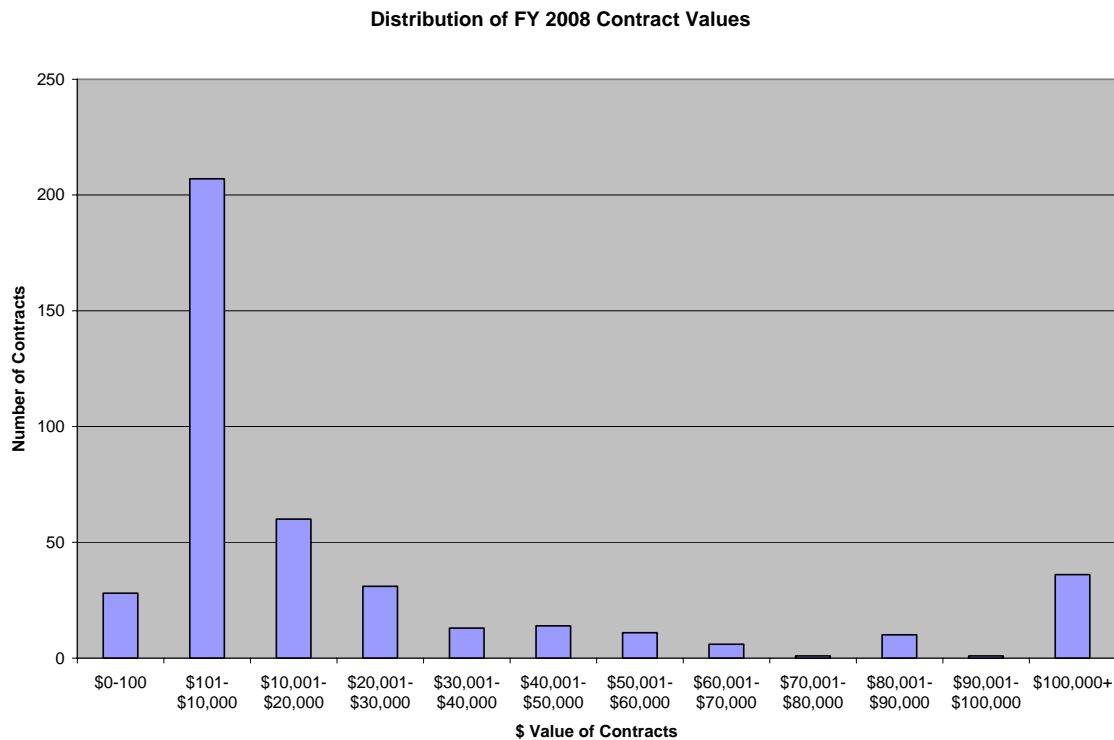
with three members of the Executive Committee to develop and study a COST survey and white paper on the Commission's audit program.

Audit staff also conducted three statistical sampling courses during the fiscal year.

B. National Nexus Program

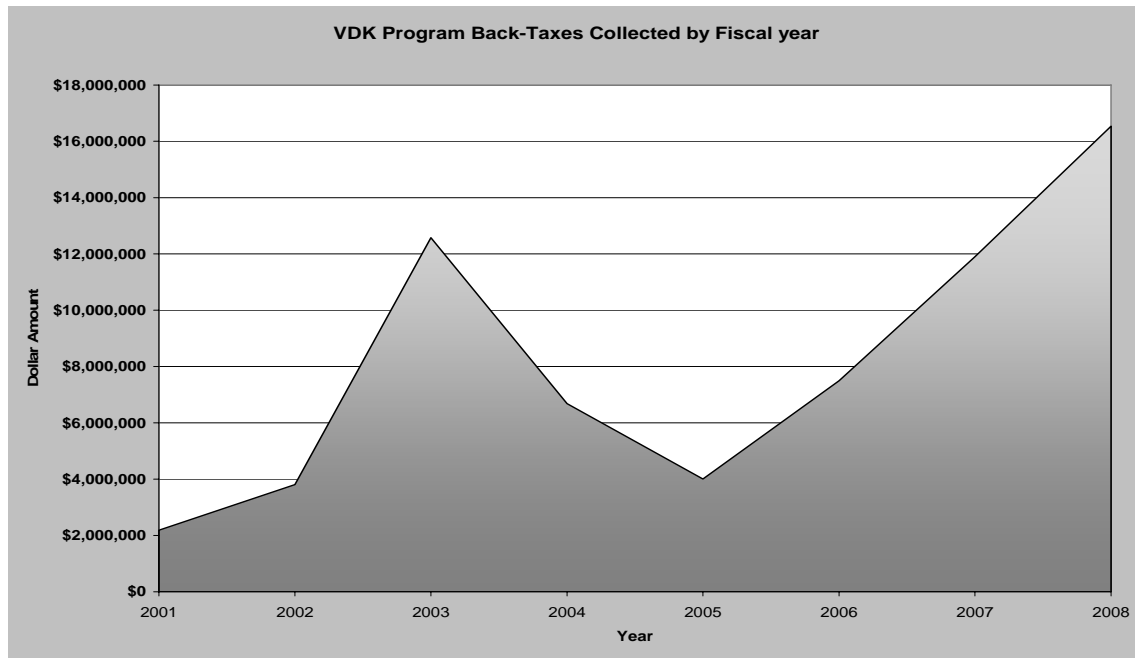
The Voluntary Disclosure Program executed contracts with 85 taxpayers, which resulted in 421 separate contracts with states and collected \$16,540,388 of revenue on behalf of member states during the fiscal year. The program has opened 71 new files (representing 620 potential disclosure contracts). Marketing of the program consisted of the distribution of more than 3,000 brochures by member states to taxpayers who may have multi-state nexus issues. The program also uses Google to get referrals; Google displays an advertisement for the National Nexus Program to those who search using certain terms, such as "voluntary disclosure."

The chart below shows the number of individual state contracts signed in FY 2008 in various revenue categories (note that most are \$10,000 or less):



The largest percentage of the total revenue comes from the very few disclosures with values in excess of \$100,000, however.

The following chart shows Voluntary Disclosure Program revenue trends from 2001 to 2008:



The Nexus Program conducted a nexus school in Nashville, Tennessee, and one in Baltimore, Maryland. No more schools are scheduled this fiscal year, but future schools are scheduled for September in Omaha, Nebraska, and October in Boise, Idaho.

Nexus staff supported the tax shelter voluntary compliance program, a separate project of 23 states which ended October 1, 2007, resulting in 36 taxpayers coming forward and collecting \$21,033,366 for the participating states.

Staff stopped work on the duration of nexus project. The Nexus Committee decided to not pursue it in light of its failure to find support from the Uniformity Committee and other reasons.

Nexus staff completed research about an industry likely not in compliance with use tax collection requirements and offered each of the larger industry members an opportunity to pursue voluntary disclosure. None accepted. Staff provided contact information and a general description of each taxpayer's business activities to the members of the Nexus Committee for disposition as they see fit.

Staff closed its investigation of a remote vendor because it was found to have come into compliance in all states. At the direction of the Nexus Committee, staff has opened an investigation of another remote vendor. This new investigation involves Nexus states testing the return policy to see whether the brick & mortar stores favor returns from its remote affiliate over those from competing vendors. The research will

also verify that the target company's brick & mortar stores accept gift certificates sold by its remote affiliate. Results are due July 21, 2008 and will be distributed to the Nexus Committee.

Nexus staff continues to work with the Nexus Committee to develop guidelines for voluntary disclosure procedure. This is an effort to provide guidance to Nexus staff, make voluntary disclosure more transparent to taxpayers, and increase efficiency through uniformity. At the March 2008 Nexus Committee meeting representative of COST (Todd) said that COST planned to offer comments on the document at a later date, after COST received input from its members. Presumably this will be delivered at the July Nexus Committee meeting.

Staff continues to work with the Technology Committee on a project to improve the program's voluntary disclosure management software, which will improve efficiency, reduce processing time, and thereby make the program more attractive to taxpayers. The Commission signed a contract with Revenue Solutions, Inc. (RSI) to develop the new system and work has begun. Completion is anticipated by fall 2008. A second phase to the project might begin after the first phase is complete.

C. Legal

In addition to staffing the Uniformity Committee and the Litigation Committee, legal staff hosted bi-monthly teleconferences for state tax attorneys. These teleconferences generally involve two presentations on topics of current interest to the states and allow time for discussion. All state tax attorneys are invited to attend. The last teleconference was held in May and included a presentation by Dan Schweitzer, Counsel for the National Association of Attorneys General, on U.S. Supreme Court decisions this term and special presentations by Doug Dowell, KY DOR, and Warren Calvert, Georgia DOR, on the *Davis* and *CSX Transportation Inc.* cases, respectively. We also held teleconferences and received presentations by Brian Fliflet, Illinois DOR, following oral argument and the issuance of the U.S. Supreme Court's opinion in *Meadwestvaco*.

Legal division support for Litigation Committee involved organizing presentations and case summaries for the November and March meeting. We are currently organizing a "satellite" Litigation Committee meeting to be held in Tennessee in October 2008. Members of the Legal Division also prepared presentations on the NCCUSL effort, recent Congressional action, a California case involving Article III of the Compact, and administrative issues including a draft exchange of information agreement specific to the procedures of Litigation Committee.

Legal staff support for the Uniformity Committee over this period included staffing the November, March, and July meetings and work on the following uniformity projects:

- Amendments to UDITPA (under development at Executive Committee and at NCCUSL)
- Amendments to MTC Model Financial Institutions Apportionment Rule (under development by a Uniformity Committee Special Work Group)
- Model Audit Sampling Authorization Statute and Accompanying Regulation (before the Commission).
- Model Statute for REITs (before the Commission)
- Model Regulation for Telecommunications and Ancillary Service Apportionment (before the Commission)
- Model Statute for RICS (Under development at Uniformity Committee)
- Model Statute Clarifying the Tax Collection Responsibilities of Accommodations Intermediaries (under development at the Uniformity Committee).
- Amendments to MTC Regulation regarding Section 18 (under development at the Uniformity Committee)
- Model Statutes for Telecommunications Transaction Tax Administration (under development at Uniformity Committee)
- New Project Regarding Income Earned by Non-Corporate Income Taxpayers Derived from an Ownership Interest in a Partnership or LLC (under development at Uniformity Committee)

The following amicus curiae briefs have been filed this fiscal year:

- *Kentucky Dep't of Rev. v. Davis*, United States Supreme Court (decided in favor of the State)
- *Surtees v. VFJ Ventures, Inc.*, Amicus Opening Brief, Alabama Circuit Court of Appeals (decided in favor of the State)
- *Surtees v. VFJ Ventures, Inc.*, Amicus Reply Brief, Alabama Circuit Court of Appeals (decided in favor of the State)
- *VFJ Ventures, Inc. v. Surtees*, Alabama Supreme Court (decision pending)
- *CSX Transportation, Inc. v. Georgia State Board of Equalization*, United States Supreme Court (decided in favor of the taxpayer)
- *MeadWestvaco Corp. v. Illinois*, United States Supreme Court (remanded)
- *Indiana v. Miller Brewing Company*, Indiana Supreme Court (decision pending)
- *Capital One v. Commissioner of Revenue*, Massachusetts Supreme Judicial Court (decision pending)
- *Gannett Satellite Information Network, Inc. v. Montana Dept. of Rev.*, Montana Supreme Court (decision pending)

Legal staff provided input to states on issues in various legal contexts, including review of briefs and draft legislation. Legal staff also monitored and reported on the activities of the Streamlined Sales and Use Tax Governing Board, Inc. and its Committees. Legal staff continues to provide assistance to the Audit Division on several cases. They also provided legal assistance regarding general Commission administration including assistance for the Commission's alternative dispute resolution process. In addition, they contributed to review and mark-up of bills before Congress.

Legal division taught the following MTC training for states this fiscal year:

- Principles of Combined Reporting, Oct. 10, 2007, Charleston, West Virginia (Sicilian)
- Nexus School, October 29, 2007, Nashville, Tennessee (Laskin)
- Principles of Corporate Income Tax Apportionment and Combined Reporting, February 28, 2008, Austin, Texas (Sicilian, Fort)
- Nexus School, April 8, 2008, Baltimore, Maryland (Laskin)
- Principles of Corporate Income Tax Apportionment, June 2-3, 2008; Salt Lake City, Utah (Sicilian, Fort)

D. Policy Research

Sales Factor for Apportioning the Net Income of Businesses Providing Telecommunications Services and Telecommunications Transaction Taxes — Elliott Dubin and research intern Andrew Nicholas and provided technical support for the Uniformity Committee's project on apportioning the net income of telecommunications service provider businesses, and submitted written comments to the Commission's hearing officer. The work on telecommunications transactions taxes is focused on estimating compliance costs for telecommunications service providers.

MTC Project on Revising Model Statute on Apportioning Income of Financial Institutions — Elliott Dubin and research intern Cameron Snow are developing a database of industries, other than financial services industries, that have substantial income from interest, and fees for services similar to services provided by financial services.

Service to States — Elliott Dubin worked with a member of the staff of the Indiana legislative fiscal committee on apportionment issues and measuring corporate income tax capacity. He also worked with Illinois revenue estimating personnel on possible methods to estimate revenue impact on individual states due to Internet Tax Moratorium extension.

Multistate Tax Commission Review — Elliot Dubin edited two articles and wrote an article for the winter 2007 issue. He has also edited an article by Professor David Wildasin (University of Kentucky) and an article by Harold Jennings and Robert Schauer of the Commission staff for the next issue. He also wrote an article for next issue of the *Review*.

Other Activities —

- Member of Nominating Committee of National Tax Association
- Organized, with Jim Landers of Indiana Legislative Fiscal Bureau, a session on State Revenue Estimating Methods for National Tax Association' Annual

Meeting in Columbus, OH. Discussed papers presented by revenue estimating staff of state revenue agencies.

- Presented short paper on Joint Cost of Compliance Study at FTA Revenue Estimating and Research Directors annual meeting in Raleigh, NC September 2007.
- Conferred with staff of U.S. Census Bureau on content and presentation of state and local government finance data to improve their website.
- Met with foreign visitors (Switzerland, Trinidad, and Isle of Man)
- Monitor state adoption of MTC model statutes, regulations, and guidelines.
- Testified before the Utah Tax Commission on apportionment issues regarding one taxpayer.
- Prepared analysis of Business Activity Tax legislation for Legislative Day.
- Prepared survey of state revenue departments regarding revenue impact of business activity tax legislation. Elliott Dubin and Cameron Snow are currently collating responses
- Hired Ann Boyd Watts as a research intern for Fall Semester; she is a graduate student at University of Tennessee, Knoxville.

E. Training

The training staff has ongoing contact with state personnel to ensure state training needs are being monitored and met.

The Commission held six courses during the fiscal year—the Nexus School (two sessions), Corporate Income Tax (one session), and Statistical Sampling for Sales and Use Tax Audits (three sessions). These courses reached 170 state and local government tax personnel, three private sector participants, and nine non-U.S. governmental participants. Other training events supported by the Commission reached over 300 additional personnel. The statistical sampling class utilizes the new MTC sampling software and is now open to private sector participants.

The following MTC courses were offered during the year:

Nexus School

October 29-30, 2007 in Nashville, Tennessee for 28 students

April 8-9, 2008 in Baltimore, Maryland for 48 students

Corporate Income Tax

June 2-5, 2008 in Salt Lake City, Utah for 54 students (38 in Part 2)

Statistical Sampling

March 31-April 3, 2008 in Little Rock, Arkansas for 11 students (test course)

April 21-24, 2008 in Denver, Colorado for 27 students

June 23-26, 2008 in Chicago, Illinois for 14 students

July 14-17, 2008 in Cheyenne, Wyoming for 31 students

The Commission staff also supported the following training events during the year:

- 2007 FTA / MTC Audit and Computer Technology Workshop in Nashville for 119 attendees on September 23-26, 2007
- Financial Reporting and Tax Disclosures—FIN 48 and Related Topics for approximately 100 students (32 in person and the remainder via telephone) at the MTC Fall Program Committee meetings in New Orleans on November 8, 2007
- Training on combined reporting for approximately 100 Texas Comptroller of Public Accounts staff members (primarily auditors) on February 28, 2008.

The following MTC training events are scheduled at this time:

Nexus Schools

- September 15-16 in Omaha, Nebraska
- October 21-22 in Boise, Idaho

2008 FTA / MTC Audit and Computer Technology Workshop, October 5-8, 2007 in Albuquerque, New Mexico (registration is being handled by FTA)

The Statistical Sampling course has been completely revised, based on new MTC sampling software. A test version of this course was held at the Arkansas Department of Revenue on March 31 – April 3. Most sessions of this course are now open to the private sector. We have had four private sector participants in the Denver and Cheyenne sessions and nine public sector attendees from British Columbia and Ireland at the course in Chicago.

The Commission has renewed its registration with the National Association of State Boards of Accountancy (NASBA) as a CPE sponsor. This registration is for “group-live” programs. Accounting boards in 44 states recognize NASBA certification for granting of CPE credit for in-person courses. The Commission also certifies attendance for CLE credit at Commission sponsored events.

II. Information Sharing with the IRS

The IRS endorsed a Memorandum of Understanding format for use by the MTC and the states to formalize information-sharing in away that would allow the Commission to handle federal taxpayer information directly. A copy of the agreement and background materials were sent to 24 states to complete and return; we have received 23 executed agreements back at this point.

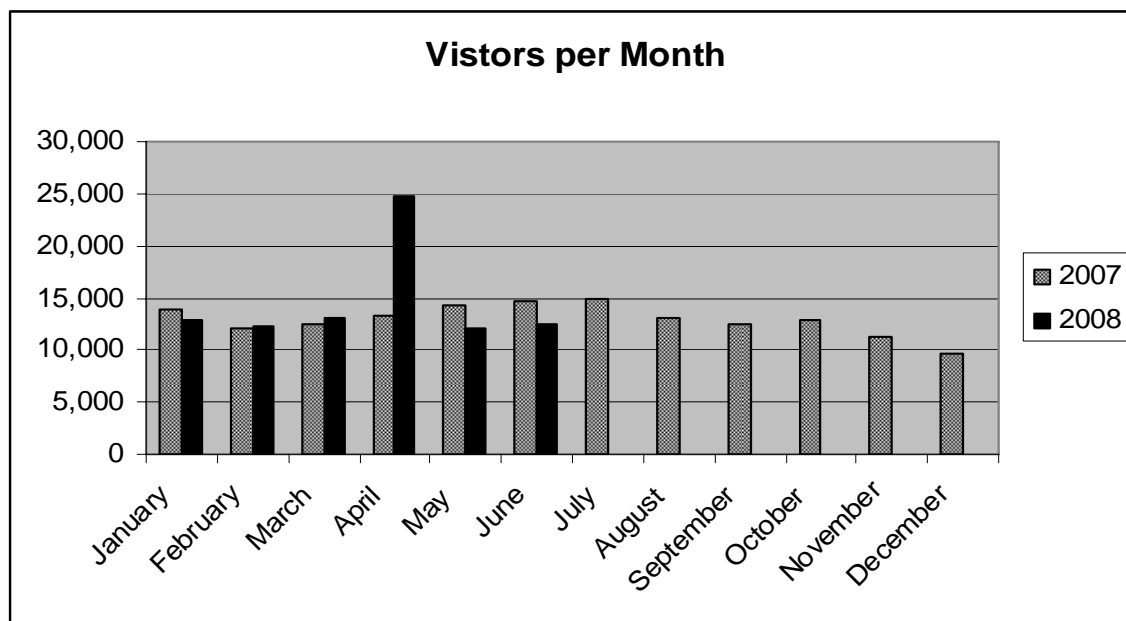
The Joint Audit Program director and the Commission's network administrator attended FTA/IRS Safeguards Symposium, March 31-April 2, 2008, in St. Louis, Missouri (the network administrator stayed on for the FTA/IRS Computer Security Conference, April 2-3, 2008, in the same location). The Commission's deputy director is working with the IRS Senior Program Analyst in the Office of Governmental Liaison assigned to the Commission toward implementation of these agreements.

The Commission, with permission from participating states, has provided the IRS with a copy of a combined audit to aid them in understanding what a joint audit looks like and the information it contains.

III. Website

Overall traffic (as measured by the total visitors per month) remains steady. As expected, traffic to the site increases just prior to Commission meetings. The site also receives referrals from other state tax agency websites as well as through the Nexus Program's efforts with Google.

The following chart shows total visitors by month, comparing 2007 and 2008:



The cause for the spike in traffic in April of this year cannot be determined; relevant statistics were higher in all categories making it difficult to figure out the likely cause or causes.

Apart from the homepage, the most popular pages are the Uniform Sales and Use Tax Exemption Certificate, the state membership map, and the Compact. The events calendar also has high traffic. It is interesting to see the amount of international visitors

to the site, notably from Canada, European countries, and China, but really from all over the world.

The deputy director is working with the website development vendor to bring the meetings registration process online as well as additional minor features that remain pending. The Technology Committee continues to monitor the status and maintenance of the Commission's website.

IV. Staffing

The following are changes to the Commission's permanent staff during the fiscal year:

Don Johnson, a senior auditor based in Chicago resigned effective August 17, 2007.

Ted Jutras took a position as a paralegal in the National Nexus Program on August 22, 2007.

Michelle Lewis started as a paralegal in the National Nexus Program on October 1, 2007.

Joe Nowinski started as a sales tax auditor in the Chicago office on November 1, 2007.

Allison Kelly, website content manager, resigned effective November 2, 2007.

Danette Smith started as an additional sales tax auditor in the Chicago office on April 14, 2008.

Sabrina Brown began working as the Commission's website manager on June 9, 2008.

John Caporale, a sales tax auditor based in the Chicago office, resigned; his last day was June 27, 2008.

V. Facilities

The Commission signed a lease for an additional 565 sq ft. of space contiguous to its current location in January 2008. The reconfiguration of the Commission's headquarters office began in April of this year and is near completion.

VI. Presentations

The following are the programs, conferences, and other events of outside organizations at which members of the staff represented the Commission during the January to June, 2008:

JULY

- SEATA Annual Conference, Orlando, Florida (Huddleston)
- Tax Executives Institute, State & Local Tax Course, Indianapolis, Indiana (Fort)

AUGUST

- NCSL Annual Meeting, Boston, Massachusetts (Huddleston)
- TEI State & Local Tax Course, Indianapolis, Indiana (Fort)
- MSATA Annual Conference, Omaha, Nebraska (Huddleston)

SEPTEMBER

- NESTOA Annual Conference, Washington, D.C. (Huddleston, Matson)
- Kansas Interim Tax Committee, Topeka, Kansas (Sicilian)
- WSATA Annual Conference, Santa Fe, New Mexico (Huddleston, Fort)
- FTA Revenue Estimating Conference, Raleigh, North Carolina (Dubin)
- ABA Tax Section Meeting, Vancouver, British Columbia (Huddleston)
- MTC Update Presentation for Sprint Corp., Kansas City, Missouri (Sicilian)

OCTOBER

- Presentation to Massachusetts Governor's Commission studying Combined Reporting, Boston, Massachusetts (Sicilian)
- SEATA Compliance and Attorneys' Workshop, Atlanta, Georgia (Huddleston)
- AFT-Public Employees Program and Policy Council Meeting, Washington, D.C. (Huddleston)
- Paul J. Hartman State & Local Tax Forum, Nashville, Tennessee (Huddleston, Sicilian, Fort)
- The Broadband Tax Institute Annual Conference, Scottsdale, Arizona (Huddleston)
- National Association of State Tax Bar Associations, Washington, D.C. (Fort)
- Multistate Tax Commission Alternative Dispute Resolution, Birmingham, Alabama (Sicilian)
- Eastern States Working Group, New York, New York (Matson)

NOVEMBER

- Chicago Tax Club's 54th Annual Fall Seminar, Chicago, Illinois (Huddleston)
- National Tax Association's Annual Meeting, Columbus, Ohio (Dubin, Huddleston)

- New Jersey Society of CPAs' Multistate Conference, Iselin, New Jersey (Shimkin)

DECEMBER

- Tennessee Society of CPAs' Tax Conference, Franklin, Tennessee (Huddleston)
- Tax Executives Institute Advanced State & Local Tax Conference, New Orleans, Louisiana (Huddleston, Sicilian)
- European Commission's Common Consolidated Corporate Tax Base Conference, Brussels, Belgium (Huddleston)
- Florida Institute for CPAs' State & Local Tax Institute, Orlando, Florida (Matson)
- NYU State & Local Tax Institute, New York, New York (Huddleston, Matson)
- Symposium on State & Local Tax Policy, Maryland State Bar Assoc. Tax Section and University of Maryland Graduate Tax Program, Baltimore, Maryland (Laskin)

JANUARY

- Georgetown State and Local Taxation, Teleconference Seminar (Sicilian)
- Tax Executives Institute, Teleconference Seminar (Sicilian, Fort)
- Cornell State & Local Tax Luncheon Group, New York, New York (Huddleston)
- Wisconsin Senate Committee on Tax Fairness, Madison, Wisconsin (Fort)
- New Mexico House Tax Committee, Santa Fe, New Mexico (Fort)
- American Bar Association 2008 Mid-Year Meeting, Las Vegas, Nevada (Huddleston)
- 17th Annual Ohio Tax Conference, Columbus, Ohio (Huddleston)

FEBRUARY

- Florida Bar Association National Multistate Tax Symposium, Orlando, Florida (Huddleston)
- Kansas House Tax Committee, Topeka, Kansas (Sicilian)
- Kansas Senate Tax Committee, Topeka, Kansas (Sicilian)
- FTA-IRS LMSB Meeting on Information Exchange with States, Ogden, Utah (Matson, Nowak)

MARCH

- NYU State & Local Tax Luncheon Group, New York, New York (Huddleston)
- ABA/IPT Advance Income Tax Symposium, New Orleans, Louisiana (Huddleston)
- Federation of Tax Administrators Executive Committee Winter Meeting; Chandler, Arizona (Fort)

- Meeting with South Carolina Chamber of Commerce, Columbia, South Carolina (Huddleston)

APRIL

- New Mexico Tax Research Institute, Santa Fe, New Mexico (Huddleston, Fort)

MAY

- Georgetown SALT Symposium, Washington, D.C. (Huddleston, Sicilian)
- Georgetown Advanced SALT Institute, Washington, D.C. (Sicilian)
- NCCUSL Drafting Group Meeting, Chicago, IL (Huddleston, Sicilian)

JUNE

- FTA Annual Conference, Philadelphia, Pennsylvania (Huddleston, Sicilian)
- American Bankers' Association Teleconference (Laskin)
- 12th Annual Multistate Tax Institute, Milwaukee, Wisconsin (Matson)
- 1st Annual Louisiana State & Local Tax Workshop, Baton Rouge, Louisiana (Huddleston)